

# **REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON MBHASHE LOCAL MUNICIPALITY**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I have audited the financial statements of the Mbhashe Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in net assets and the statement of cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2011 (Act No. 6 of 2011) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-General's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

### **Basis for qualified opinion**

#### **Property, plant and equipment**

6. The municipality did not apply the requirements of GRAP 17 and Directive 7 appropriately and did not have adequate systems in place to maintain records of property, plant and equipment (PPE). The asset register exceeded the amount stated on the financial statements by R39,42 million (2011: R81,45 million) and value-added tax amounting to R2,88 million was incorrectly capitalised.
7. In addition, sufficient appropriate audit evidence was not available to confirm assets amounting to R32,22 million (2011: R58,12 million) disclosed as property, plant and equipment in note 9 to the financial statements. Consequently, I was unable to determine whether any further

adjustments were necessary to the amount disclosed for property, plant and equipment in note 9 to the financial statements of R162,56 million (2011: R137,33 million).

#### **Irregular expenditure**

8. I was unable to obtain sufficient appropriate audit evidence about the completeness of irregular expenditure reflected as R29,49 million (2011: R29,25 million) per note 32 of the financial statements. I was unable to confirm the balance by alternative means. Consequently, I was unable to determine whether any adjustments to this amount were necessary.

#### **Commitments**

9. Commitments are disclosed at R17,05 million (2011: R33,29 million) in note 28 to the financial statements. Audit procedures revealed that commitments are understated by an amount of R8,86 million (2011: R24,12 million). This was as a result of no contract management system being in place for the identification and recognition of contracts.

#### **Accumulation of immaterial uncorrected misstatements**

10. The statement of financial position is materially misstated due to the cumulative effect of individually immaterial uncorrected misstatements on payables from exchange transactions reflected as R3,75 million (2011: R4 million) being misstated by R466 358 (2011: R1,42 million).
11. In addition, I was unable to obtain sufficient appropriate audit evidence and I was unable to confirm or verify the following elements by alternative means. Provisions reflected as R950 982 (2011: R898 000), as a result, I was unable to determine whether any adjustments to these elements were necessary.

#### **Qualified opinion**

12. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Mbhashe Local Municipality as at 30 June 2012 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

#### **Emphasis of matters**

13. I draw attention to the matter below. My opinion is not modified in respect of this matter.

#### **Restatement of corresponding figures**

14. As disclosed in note 36 to the financial statements, the corresponding figures for the year ended 30 June 2011 have been restated as a result of errors discovered during the current financial year and as a result of the municipality being required to comply with subsequent measurement criteria of the generally recognised accounting practice (GRAP) accounting framework in the financial statements of Mbhashe Local Municipality at, and for year ended 30 June 2012.

#### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

15. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

#### **Predetermined objectives**

16. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages ... to ... of the annual report.
17. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned development priorities. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury *Framework for managing programme performance information* (FMPPI).
18. The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
19. The material findings are as follows:

### **Usefulness of information**

#### **Presentation**

20. Improvement measures in the annual performance report for all the planned targets not achieved were not disclosed as required by section 46 of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA). This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information.

#### **Consistency**

21. Section 41(c) of the MSA requires that the integrated development plan (IDP) should form the basis for the annual report, therefore requiring the consistency of objectives, indicators and targets between planning and reporting documents. A total of 51% of the reported objectives, a total of 84% indicators and all the reported targets are not consistent with the objectives, indicators and targets as per the approved integrated development plan. This is due to the lack of review, monitoring and standard operating procedures not in place for the recording of the reported information by senior management.

#### **Measurability**

22. The National FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. All the targets were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was not aware of the requirements of the FMPPI and that it was the first year of reporting on predetermined objectives.
23. The FMPPI requires that performance targets be measurable. The required performance could not be measured for all the targets. This was due to the fact that management was not aware of the requirements of the FMPPI and that it was the first year of reporting on predetermined objectives.

### **Reliability of selected development priorities in the annual performance report**

#### **Validity and accuracy**

24. The FMPPI requires that processes and systems which produce the indicator should be verifiable and accurate enough for its intended use and respond to changes in the level of performance. All the actual reported performance relevant to the selected objectives was not

valid and accurate when compared to the source information or evidence provided. This was due to a lack of monitoring, review and standard operating procedures not in place for the recording of reported information by senior management.

#### **Completeness**

25. The FMPPI requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. All the actual reported performance, for the selected objectives, was not completely recorded. This was due to a lack of improper document management system with regard to actual performance achievements.

#### **Additional matter**

26. I draw attention to the following matter below. This matter does not have an impact on the predetermined objectives audit findings reported above.

#### **Achievement of planned targets**

27. Of the total number of planned targets, none were achieved during the year under review. This represents all the planned targets that were not achieved during the year under review.

#### **Compliance with laws and regulations**

28. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

#### **Strategic planning and performance management**

29. The municipality did not conduct its affairs in a manner which was consistent with its IDP, as required by section 36 of the MSA and Municipal Planning and Performance Management Regulation 6.
30. The municipality did not monitor measure and review performance, with regard to each of those development priorities and objectives and against the key performance indicators and targets set and take steps to improve performance with regard to those development priorities and objectives where performance targets are not met as required by section 41 of the MSA.

#### **Budgets**

31. Monthly budget statements were not timeously submitted to the relevant provincial treasury, as required by section 71(1) of the MFMA.
32. The accounting officer did not assess the first half of the financial year performance of the municipality, as required by section 72(1) and section 72(1)(a)(ii) of the MFMA.

#### **Annual financial statements, performance and annual report**

33. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were subsequently corrected but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.
34. The accounting officer did not make the 2010/11 annual report public immediately after the

annual report was tabled in the council, as required by section 127(5)(a) of the MFMA.

35. The accounting officer did not make public the council's oversight report on the 2010/11 annual report within seven days of its adoption, as required by section 129(3) of the MFMA.
36. The annual performance report for the year under review does not include a comparison of the performance with set targets, a comparison with the previous financial year and measures taken to improve performance, as required by section 46 (1)(a)(b)(c) of the MSA.

#### **Audit committees**

37. A performance audit committee was not in place and the audit committee established in terms of MFMA section 166(1) was not used for this function, as required by Municipal Planning and Performance Management Regulation 14(2)(a).

#### **Internal audit**

38. The internal audit did not audit the results of performance measurements, as required by section 45(1)(a) of the MSA and Municipal Planning and Performance Management Regulation 14(1)(a).
39. The internal audit unit did not assess the functionality of the performance management system, as required by Municipal Planning and Performance Management Regulation 14(1)(b) (i).
40. The internal audit unit did not audit the performance measurements on a continuous basis and submitted quarterly reports on their audits to the municipal manager and the performance audit committee, as required by Municipal Planning and Performance Management Regulation 14(1)(c).

#### **Procurement and contract management**

41. Goods and services with a transaction value of between R10 000 and R200 000 were procured without obtaining written price quotations from at least three different prospective providers as per the requirements of Supply Chain Management Regulation 17(a) & (c).
42. Quotations were accepted from prospective providers who are not registered on the list of accredited prospective providers and do not meet the listing requirements prescribed by the supply chain management (SCM) policy in contravention of SCM Regulations 16(b) and 17(b).
43. The preference point system was not applied in all procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM Regulation 28(1)(a).
44. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
45. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM Regulation 13(c).
46. Awards were made to providers who are persons in the service of other state institutions or whose directors/ principal shareholders are persons in the service of other state institutions, in contravention of SCM regulation 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

### **Conditional grants**

47. The municipality did not submit quarterly performance reports to the transferring national officer, the relevant provincial treasury and the National Treasury, within 30 days after the end of each quarter, as required by section 12(2)(c) of the DoRA.
48. The municipality did not register its master plans for bulk infrastructure with the Integrated National Electrification Programme (INEP), as required by the Division of Revenue Grant Framework, *Government Gazette No.34280*.

### **Expenditure management**

49. The accounting officer did not take effective steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

### **Revenue management**

50. Interest was not charged on all accounts in arrears as, required by section 64(2)(g) of the MFMA.
51. Revenue received was not always reconciled on a weekly basis, as required by section 64(2)(h) of the MFMA.

### **Asset management**

52. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
53. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

### **Internal control**

54. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

### **Leadership**

55. The municipality was not able to achieve stability of leadership during the current year and due to political infighting, suspensions and personnel were acting in senior positions. This resulted in a lack of oversight as sufficient monitoring controls to ensure proper implementation of policies at an operational level and that the audit action plan was fully addressed.
56. The municipality has not developed documented and approved internal policies and procedures to address the collection, recording, processing, monitoring and reporting on predetermined objectives. Consequently, the annual performance report was not useful or reliable.

### **Financial and performance management**

57. The municipality did not have adequate systems in place for the complete and accurate

financial reporting of irregular expenditure, commitments and PPE. This is as a result of the irregular expenditure brought forward from prior years being incomplete. While for commitments and PPE the respective registers were not maintained throughout the year and did not agree with supporting documentation provided. In addition, for PPE the register did not reconcile with the amounts reported in the annual financial statements.

58. The municipality did not have a proper system of record management that provides for the maintenance of information that supports the reported information contained in the annual performance report. This includes information which relates to the collection, collation, verification, storing and reporting of actual performance information. As a result the annual performance report was not useful or reliable.
59. The municipality did not adequately assign responsibility and implement processes to monitor compliance with the approved budget and ensure compliance with all applicable laws and regulations. The municipality thus did not fully comply with all the requirements of the MFMA, the MSA, MPPM and SCM Regulations.

### **Governance**

60. The municipality only completed the risk assessment as required by the MFMA at the end of the financial year. Consequently, there was failure to monitor compliance with the MFMA, MSA, MPPM and SCM regulations. As well as the GRAP reporting framework requirements.
61. The recommendations of the audit committee and internal audit are not adequately addressed, with the result that these internal control deficiencies remain uncorrected.
62. The performance audit committee was not appointed and the internal audit function did not have the necessary capacity to review or report on the performance management system or performance reports during the year under review. The municipality thus lost the benefit that may have been obtained had these reports been completed.

*Auditor-General*

East London

30 November 2012



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